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GENERAL ACCOUNTING OFFICE WASHINGTON DC INTERNATIONAL DIV F/G 5/3
POLICY NEEDED AT EXIMBANK FOR FINANCING AIRCRAFT SPARE PARTS AN--ETC(U)

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BY THE COMPTROLLER GENERAL

Report To The Honorable
William Proxmire,
United States Senate.

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(6) Policy Needed At Eximbank For
Financing Aircraft Spare Parts
And Other Support Items.

The Export Import Bank of the United States (Eximbank) finances aircraft spare parts and other support items in connection with loans for commercial aircraft. Borrowers obtain support items either by direct purchase or through credit memorandums issued by airframe and engine manufacturers.

To effectively use its scarce financial resources, Eximbank should limit the amount of spare parts and other support items in direct long-term financing for commercial aircraft sales. Also, to reduce interest costs to the Government, Eximbank should delay disbursement of loan funds for items obtainable with credit memorandums until the memorandums are used.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-203743

The Honorable William Proxmire
United States Senate

Dear Senator Proxmire:

In response to your letter of March 18, 1981, we reviewed credit memorandums and related matters concerning Eximbank loans to Ansett Aviation Equipment, Ltd., of Australia and to the Government of Israel for assistance in purchasing commercial aircraft. Other information of a proprietary nature is being transmitted separately.

As arranged with your office, we discussed our draft report with Eximbank officials and considered their comments.

As arranged with your office, unless you publicly announce the contents earlier, we plan no further distribution of this report until ten days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Acting Comptroller General
of the United States

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REPORT BY THE COMPTROLLER GENERAL
TO THE HONORABLE WILLIAM PROXMIRE
UNITED STATES SENATE

POLICY NEEDED AT EXIMBANK
FOR FINANCING AIRCRAFT SPARE
PARTS AND OTHER SUPPORT ITEMS

D I G E S T

The Export-Import Bank of the United States (Eximbank) helps to finance the sale of U.S. exports through loans, loan guarantees, and insurance programs. Senator Proxmire requested GAO to review the use of credit memorandums in connection with two commercial aircraft loans approved by Eximbank in April 1981. Credit memorandums, granted by manufacturers as concessions in negotiating these sales, enable buyers to obtain extra spare parts, ground equipment, training, and other support items for aircraft at no additional cost.

GAO believes that Eximbank should establish a more restrictive policy for financing aircraft support items, whether or not they are obtained directly or through credit memorandums.

One of the loans, to Ansett Aviation of Australia, involved \$289.3 million, representing 63.3 percent of U.S. costs for 18 aircraft, spare parts, and other support items.

The second loan, to the Government of Israel, involved \$172.6 million, representing 75 percent of U.S. costs for six aircraft, spare parts, and support items.

Boeing Company manufactures the airframes and General Electric Company and Pratt & Whitney Aircraft Group of United Technologies Corporation manufacture the engines for these aircraft.

EXIMBANK FINANCING OF
ANSETT AND ISRAEL LOANS

Ansett loan

U.S. costs for the Ansett loan total \$456.9 million--\$379.5 million for aircraft and \$77.4 million for identified spare parts and other support items (20.4 percent of aircraft costs).

Boeing and General Electric granted credit memorandums worth millions of dollars to Ansett to enable it to obtain additional spare parts and support items. Members of the Eximbank staff noted that the credit memorandums reduce aircraft costs and increase support items costs, thus increasing the percent of spares and other items to aircraft costs.

In considering the loan, Eximbank staff members noted the Bank's recent efforts to reduce support for spare parts but said that the use of credit memorandums is a longstanding practice in the aircraft industry. In line with Eximbank guidelines, the staff members said the credit memorandums were eligible for financing and recommended that the Eximbank Board of Directors approve the requested loan amount.

The Eximbank Board thoroughly discussed the Bank's practices for financing aircraft spare parts and other support items, either directly or through credit memorandums. Many of these items are used in a year or two, and yet the airline receives the same 10-year financing for them as it receives for the aircraft itself. The Board, however, did not want to treat Ansett differently than other airlines had been treated in previous cases. It therefore approved the loan, but recognized that the Bank should review its financing practices. (See p. 4)

Israel loan

U.S. costs for the loan to Israel total \$230.2 million--\$189.9 million for aircraft and \$40.3 million for identified spare parts and other support items. The spare parts and support items are 21.2 percent of aircraft costs. Boeing and Pratt & Whitney granted credit memorandums worth millions of dollars to enable Israel to obtain additional spare parts and support items.

The Eximbank Board of Directors noted that the credit memorandums increase the percent of spare parts and other items to aircraft costs. As with Ansett, the Board approved financing for these items because it did not want to single out Israel for different treatment than had been given in earlier cases. (See p. 9)

Possible premature
disbursement of loan funds

Under current Eximbank procedures, credit memorandums issued to Ansett and Israel in connection with the purchase of aircraft financed by Eximbank may be used to obtain spare parts and other support items after the aircraft are delivered and loan funds have been fully disbursed. GAO believes that if this occurs, Eximbank will prematurely disburse loan funds for the unused credit memorandums and increase interest costs to the Government. (See pps. 8 and 10)

EXIMBANK NEEDS A POLICY FOR
FINANCING AIRCRAFT SPARE
PARTS AND OTHER SUPPORT ITEMS

The issue concerning Eximbank financing for too many spare parts and support items for aircraft was first raised in November 1979. In April 1981, a proposal was made to limit Eximbank's financing for spare parts and other support items, including those obtained with credit memorandums, to a maximum of 10 percent of aircraft costs. Eximbank has begun to study this matter. The present Board of Directors will recommend that the next Board determine whether Eximbank should reduce financing of spare parts and similar items on a long-term basis in light of the Bank's scarce resources. (See p. 11)

The major U.S. aircraft and engine manufacturers were concerned that any reduction in Eximbank financing for spare parts and accessory items would adversely affect their capability to compete with foreign manufacturers. They were especially concerned about competition from Airbus Industrie and said that the Governments of France, Germany, and the United Kingdom provide financial and political support to advance the competitive position of Airbus. The U.S. aircraft industry, however, said that it will work closely with Eximbank to develop a system for effectively using available Bank resources. (See p. 12)

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS

GAO believes that Eximbank, to effectively use its scarce financial resources in competing with resources available to assist foreign aircraft manufacturers, should limit the amount of spare parts and other support items in direct long-term financing for commercial aircraft sales. Also, to reduce interest costs to the Government, Eximbank should not pay out loan funds for the value of credit memorandums until the memorandums have been used by borrowers to obtain spare parts and other support items.

GAO recommends that Eximbank establish a policy limiting the amount of spare parts and other support items in its direct long-term financing for commercial aircraft sales and that it delay disbursement of loan funds for items obtainable with credit memorandums until the memorandums are used.

Eximbank officials generally agreed that the Bank should establish a new policy for financing aircraft spare parts and other support items and said that GAO's recommendation would be considered. In commenting on the second part of the recommendation, they said that Eximbank's procedures would have to be changed in order to withhold disbursement of loan funds until credit memorandums are used, and this would create additional administrative work.

GAO does not believe that implementing this part of the recommendation would create an unreasonable administrative burden on the Eximbank staff. The Bank could use the same procedures when spares and other items are obtained with credit memorandums as it uses when these items are obtained directly. (See p. 14)

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CHAPTER 1
INTRODUCTION

The principal activities of the Export-Import Bank of the United States (Eximbank) are to aid in financing and to facilitate exports from the United States to foreign countries. Eximbank makes direct loans to foreign buyers, usually in conjunction with loans made by others, to finance the export of U.S. goods and services sold on credit terms. It also guarantees the repayment of export loans made by others and insures amounts owed by foreign buyers to U.S. exporters.

The U.S. aircraft industry is the largest single user of Eximbank programs. In 1979, sales of aircraft and related spare parts and support items accounted for \$1.4 billion, or 38.2 percent, of Eximbank's loan authorizations.

OBJECTIVES, SCOPE, AND METHODOLOGY

Senator William Proxmire asked us to review Eximbank loans to Ansett Aviation, Ltd., of Australia and to the Government of Israel to determine whether rebate practices in the form of credit agreements not appearing on the public record were in effect. In accordance with discussions with the Senator's office, we also focused on a related issue of whether it is appropriate for Eximbank to finance such items as spare parts, ground support equipment, and crew training as part of the financial package for commercial aircraft sales.

We discussed these matters with Eximbank officials and reviewed Eximbank's files for the Ansett and Israel loans and tapes of meetings by the Eximbank Board of Directors to approve the loans.

We talked with officials of the five largest U.S. aircraft and engine manufacturers--Boeing, McDonnell Douglas, Lockheed, General Electric, and Pratt & Whitney--to obtain information on the use of credit memorandums in the industry and their views on Eximbank's policy for financing spare parts and other support items as part of the aircraft sales package. Proprietary information is being furnished to the Senator under separate cover.

Our work was performed primarily from April to June of 1981. As arranged with the Senator's office, we discussed our draft report with Eximbank officials and considered their comments.

CHAPTER 2

FINANCING OF SPARE PARTS AND CREDIT MEMORANDUMS

IN ANSETT AND ISRAEL LOANS

Eximbank, in reviewing applications by Ansett Aviation and the Government of Israel for financial assistance, considered the effect that credit memorandums would have on the amount of spare parts and accessory items that would be financed as part of the loan package. Some Eximbank officials stated that the Bank was financing an excessive amount of spares and support items on the same long-term basis as the aircraft itself. Eximbank approved the loans because it did not want to treat Ansett and Israel differently than other applicants for financial assistance had been treated in the past; however, it recognized the need to review its practices for financing spare parts and other support items.

We believe that Eximbank also should review procedures for paying out loan funds to assure that premature disbursements are not made for the amount of unused credit memorandums.

CREDIT MEMORANDUMS

Credit memorandums are granted during sales negotiations in response to competing manufacturers' offers; they are a concession to induce prospective customers to purchase an equipment package consisting of aircraft and support items. Negotiations over credit memorandums will be completed before Eximbank disburses loan funds but, in some cases, they may not be completed at the time it gives final loan approval.

Aircraft and engine manufacturers issue credit memorandums so that purchasers may obtain a specified amount of goods and services from the manufacturers or from other suppliers. They are used to obtain spare parts, ground support equipment, training, advertising, and other services in addition to such items already ordered. There is no increase in cost for the additional items. Credit memorandums may also be used to obtain cash discounts on the sales price for aircraft.

Credit memorandums are generally issued upon delivery of aircraft; if more than one aircraft has been purchased, a proportionate amount of the credit memorandums may be issued with each aircraft delivery. The purchaser does not have to use credit memorandums for goods and services at the time of delivery, and sometimes does not use them until a future date. Eximbank does not obtain information showing when credit memorandums for goods and services are used.

In a January 18, 1979, letter to the Boeing Company, Eximbank set forth its policy on the use of credit memorandums. Eximbank does not deduct from the price of the aircraft the amount of a credit memorandum if it (1) is used to purchase U.S. goods and services in support of U.S. aircraft, (2) is not used for making cash payments to the buyer, and (3) is not used to purchase goods and services that have been or will be financed by Eximbank. If a credit memorandum does not meet these criteria, the amount of the memorandum is deducted from the purchase price and Eximbank financing is reduced accordingly.

PROCEDURES FOR
REVIEWSING LOAN REQUESTS

Requests for financial support are reviewed by economic, engineering, legal, and loan members of the Eximbank staff. Generally, preliminary and final reviews are made covering the cost of financing the transaction and foreign competition for financing the transaction. The staff members summarize the results of their evaluation in a memorandum to the Eximbank Board of Directors, with a recommendation to approve or disapprove the request. In final reviews, the memo discusses differences between the Bank's preliminary commitment and the proposed final loan.

Periodically, the Eximbank Board of Directors meets to act on requests for financial assistance, and Bank staff members attend to advise the Board. Loans for \$30 million or more are referred to the National Advisory Council and loans for \$100 million or more are also submitted to the Congress for review before final approval by Eximbank.

ANSETT LOAN

On April 14, 1981, Eximbank authorized a \$289.3-million loan to Ansett to finance the acquisition of 18 commercial aircraft, related spare parts, and support items from the Boeing Company to be delivered between 1982 and 1984. The engines for the aircraft will be provided by the General Electric Company and the Pratt & Whitney Aircraft Group of United Technologies Corporation.

Eximbank's loan represented 63.3 percent of the U.S. export value of the sale. Private bank financing will be used for 21.7 percent (\$99.1 million) of the sale and Ansett will make a 15 percent cash payment of \$68.5 million. The private bank financing is not guaranteed by Eximbank. A breakdown of Eximbank's financing by aircraft type is presented on the following page.

<u>Item financed</u>	<u>Total U.S. export value</u> <small>(000 omitted)</small>	<u>Eximbank financing</u>	<u>Percent financed</u>
5 B-767s with General Electric engines, spares, and support	\$235,074	\$199,813	85
4 B-727s with Pratt & Whitney engines, spares, and support	69,616	34,550	49.6
9 B-737s with Pratt & Whitney engines, spares, and support	<u>152,203</u>	<u>54,888</u>	36.1
Total	<u>\$456,893</u>	<u>\$289,251</u>	63.3

The overall blended interest rate for Eximbank and private credits (together totaling 85 percent of the U.S. cost) is estimated to be 9.75 percent a year. Eximbank's cost of financing is 8 percent per annum for the B-767s, 8.375 percent for the B-727s, and 8.4 percent for the B-737s. In addition, Eximbank will charge a commitment fee of 0.5 percent per annum on the undisbursed portion of its loan, which is repayable over 10 years.

Board consideration of loan
and data prepared by staff

The February 10, 1981, staff members' memo to the Eximbank Board of Directors noted that U.S. costs for the Ansett transaction totaled \$456,893,300--\$379,530,300 for aircraft and \$77,363,000 for identified spare parts and support items. The spare parts and support items are shown below. They represent 20.4 percent of aircraft costs.

<u>Item</u>	<u>Cost</u>
Airframe spares	\$29,967,000
Spare engines	14,360,000
Engine spares	4,492,000
Ground support equipment	13,590,000
Crew training	8,771,667
Quick engine change equipment and tooling	5,061,833
Buyer-furnished equipment	<u>1,120,000</u>
Total	<u>\$77,362,500</u>

Credit memorandums apply only
to B-767 aircraft

Boeing and General Electric issued credit memorandums worth millions of dollars to Ansett solely to induce Ansett to buy B-767 aircraft; they did not apply to the B-727s and B-737s.

In the total \$456,893,000 U.S. costs for all aircraft, \$235,074,000 was for the B-767s--\$189,481,500 for the aircraft and \$45,592,500 for identified spare parts and support items. Eximbank staff members said the B-767 costs included the amount of the credit memorandums. According to these staff members, this suggested that the airline is receiving five B-767s valued at \$189,481,500, but, in consideration for the purchase, the manufacturers agreed to include additional spare parts and support items for the value of the credit memorandums at no increase in cost. Thus, the staff members said that the actual cost for the aircraft could be considered to be reduced by the credit memorandums, which increases the percent of spare parts and support items in relation to U.S. and aircraft costs for the 767s.

Impact when credit memorandums
applied to entire transaction

Some Eximbank officials, in order to reduce the Bank's overall financial support for the credit memorandums, questioned whether the memorandums should be applied to the entire sale, and not just to the B-767s. This would increase the percent of spare parts and support items in relation to U.S. and aircraft costs for the entire transaction.

Staff recommendation

The staff, noting the Bank's recent efforts to reduce support for spare parts, said that the use of credit memorandums is a longstanding practice in the aircraft industry; Ansett, Boeing, and General Electric negotiated the memorandums on this basis and on the guidance in Eximbank's January 18, 1979, letter. In this context, the staff said that the credit memorandums were eligible for financing under the B-767 portion of the sale and recommended that the loan be approved.

Board deliberation and approval

On February 24, 1981, the Board of Directors and the staff met to consider Ansett's request for financial support and discussed in detail the financing of credit memorandums and spare parts.

One director read the following statement into the record so there would be no confusion about his position. He said, in part, that:

"Ansett's final credit application as presented to the Board here today is a prime example of Exim financing far too many spare parts and ground equipment in aircraft cases in general, many of these items to be used in the first one or two years of operation of the planes involved in the credit, and yet the airline is getting 10-year financing for these items.

"In the Ansett case, the combination of credit memos, and specifically detailed spare parts and ground support equipment, amounts to a very high percentage of the base price of the 18 aircraft. I am not intimating that credit memos are illegal, but merely a clever negotiating tool between aircraft manufacturer and airline customer, however, resulting in many cases in our financing excessive spares."

This director did not want Ansett to be treated differently than other cases involving spare parts, ground support equipment, and credit memorandums. He intended to vote for the loan exactly as presented by the staff, but with the admonition that before the Board issued any more preliminary commitments in aircraft cases, it establish a policy that (1) spares, ground support equipment, and the like, including credit memorandums, be totally excluded from direct loan support or (2) a reasonable maximum figure for spares from any source be set, such as at 5 or 10 percent, in addition to a reasonable complement of spare engines. He said that budget constraints do not allow Eximbank any further delay over this issue.

The Board Chairman concurred with this director's goals. He said that Eximbank would not be approving any preliminary commitments for loans in the next few weeks and should discuss policy with the five airframe and engine manufacturers for financing spares and credit memorandums. The Chairman did not want the Board to take unilateral action that would make U.S. exporters less competitive with foreign exporters.

Another director, considering Eximbank's difficult budget situation, would limit Bank financing to aircraft and, perhaps, spare engines. He said that the present Board could not resolve the problem but should be helpful to the new Board. A third director did not want the Bank to make any hasty decision about financing aircraft until the situation was reviewed.

A staff member who attended the meeting said that:

"We're trying to define a credit memo. It seems to me that it is a marketing device that conceals the value of the various components of an aircraft export transaction. When a credit memo is provided to a foreign airline by a U.S. aircraft manufacturer it is in effect a discount from the base price of the aircraft. Such credit memos can be used for spare parts, training and other aircraft related goods and services.

"The inclusion of credit memos may create an undesirable mix in the capital and consumable components of the transaction. Although it is not Exim's province to decide the merits of an aircraft manufacturer's marketing strategy, it is incumbent on us to distinguish between capital and consumable components on the transactions that we finance in order to decide the appropriate terms and conditions of our support in the most efficient use of our resources."

This staff member noted that:

--Airframes, installed engines, and a reasonable number of spare engines are capital items and deserve Eximbank's long-term financial support.

--Spare parts are consumed in 6 to 18 months and do not deserve 10 years' financing support from Eximbank.

--Ground support equipment can probably be considered as capital equipment but its useful life is not as long as the aircraft or engines. The Bank's medium-term program may be the most appropriate means of supporting these items.

This staff member commented that the amount of spare parts and other support items in the Ansett transaction is excessive. He said that, should the Board decide to stop financing spare parts and credit memorandums, this transaction would be the place to start because it may be the first time the magnitude of the issue has been brought to the Board's attention.

Further discussion of the matter included whether the credit memorandums should be allocated among the three aircraft financial plans rather than entirely to the B-767 aircraft. Allocation to the three aircraft would reduce Eximbank financing of the credit memorandums from 85 percent to 63.3 percent.

The Chairman said that the Board should reach a decision quickly and that, if it did not approve the Ansett loan as recommended by the staff, the action would be arbitrary, based on past practices. The five directors voted unanimously to approve the staff recommendation and refer the loan to the National Advisory Council. 1/ One director, however, wanted the credit memorandums allocated over the three aircraft financial plans.

Possible premature disbursement
of loan funds

Under current procedures for financing credit memorandums, Eximbank could prematurely disburse Ansett loan funds. As the staff memo to the Board noted, the cost of \$189,481,500 for five B-767 aircraft could be considered to be reduced by the value of spare parts and support items to be obtained with credit memorandums. Eximbank will disburse a proportionate part of the aircraft portion of the loan as each aircraft is delivered. When all aircraft have been delivered, Eximbank will have disbursed \$161,059,270, 85 percent of \$189,481,500. The documents against which Eximbank disburses funds do not distinguish between delivery of aircraft and delivery of items obtained with credit memorandums. Thus, to the extent that Ansett does not use the credit memorandums upon delivery of the aircraft, Eximbank will prematurely disburse loan funds and increase interest costs to the Government. These disbursements could amount to as much as 85 percent of the value of the credit memorandums.

ISRAEL LOAN

On April 14, 1981, Eximbank authorized a loan totaling \$172.6 million to the Government of Israel for the purchase of six commercial aircraft, related spare parts, and support items from the Boeing Company to be delivered between 1982 and 1984. The aircraft will be powered by Pratt & Whitney engines.

Although the aircraft are being purchased for use by EL AL Israel Airlines, Limited, the Government of Israel is the borrower because EL AL may be replaced by another Israeli flag carrier owned by the Government, and the latter may eventually become the owner of the aircraft.

Eximbank's loan, as shown on the following page, represented 75 percent of U.S. export value of the sale. A Boeing credit will be issued for 10 percent (\$23 million) of the sale and Israel will make a 15 percent cash payment of \$34.5 million. The Boeing credit is covered by Eximbank guarantee.

1/In early March 1981, the Council advised Eximbank that it had no objection to approval of the loan.

<u>Item financed</u>	Total U.S. <u>export value</u> <u>(000 omitted)</u>	Eximbank financed	Percent financed
4 B-767s with Pratt & Whitney engines, spares and support	\$194,005	\$145,504	75
2 B-737s with Pratt & Whitney engines, spares and support	<u>36,170</u>	<u>27,127</u>	75
Total	<u>\$230,175</u>	<u>\$172,631</u>	75

The interest rate for the Eximbank loan and Boeing credit will be 9.25 percent a year. In addition, Eximbank will charge a commitment fee of 0.5 percent a year on the undisbursed amounts of its loan. It will also charge a guarantee commitment fee of 0.125 percent on the undisbursed amount of the Boeing credit and a guarantee fee of 0.5 percent on the disbursed amount. The Eximbank loan is repayable over 10 years.

Board consideration of loan and data prepared by staff

The February 12, 1981, staff members' memo to the Eximbank Board stated that U.S. costs for the Government of Israel transaction totaled \$230,175,000--\$189,925,000 for B-737 and B-767 aircraft and \$40,250,000 for identified spare parts and support items. The spare parts and support items are shown below. They represent 21.2 percent of aircraft costs.

<u>Item</u>	<u>Cost</u> (000 omitted)
Airframe spares	\$16,300
Spare engines	13,070
Engine spares	5,975
Ground support equipment	3,800
Training	<u>1,105</u>
Total	<u>\$40,250</u>

Although not mentioned in the memo, U.S. costs included credit memorandums issued by Boeing and Pratt & Whitney worth millions of dollars. Thus, using the same reasoning applied by Eximbank staff members in the Ansett case, it could be asserted that the actual cost of aircraft to Israel is reduced by the amount of the credit memorandums, which increases the percent of spare parts and support items in relation to U.S. and aircraft costs. The staff said that transaction costs are reasonable and recommended that the Board approve the loan.

On March 3, 1981, the Board of Directors met to consider the Government of Israel's request to convert the Bank's preliminary commitment to a final commitment for the purchase of two B-737s and four B-767s. The discussion of spare parts and credit memorandums was brief at this meeting; a director noted that, when the credit memorandums are considered, they increase the percent of spare parts and other support items to the base price of the aircraft. For the same reason given for approving the Ansett loan, the director recommended that the Israel loan be approved but that these percentages be considered by the Board in future cases. The Board agreed to refer the loan to the National Advisory Council. 1/

Possible premature disbursement
of loan funds

Eximbank could prematurely disburse Israel loan funds if credit memorandums are not used upon delivery of aircraft. The cost of \$189,925,000 for six aircraft could be considered to be reduced by the amount of spare parts and other support items to be obtained with credit memorandums. When all aircraft are delivered, Eximbank will have disbursed loan funds amounting to \$142,443,750, 75 percent of \$189,925,000. As previously noted, the documents against which Eximbank disburses funds do not distinguish between delivery of aircraft and delivery of items obtained with credit memorandums. Therefore, if Israel does not use the credit memorandums upon delivery of the aircraft, the Bank will prematurely disburse funds for the value of unused memorandums and increase interest costs to the Government. Such disbursements could amount to 75 percent of the credit memorandums.

1/On about March 9, 1981, the Council advised Eximbank that it had no objection to approval of the loan.

CHAPTER 3

POLICY NEEDED FOR FINANCING

AIRCRAFT SPARE PARTS AND OTHER SUPPORT ITEMS

Eximbank has initiated a study of the need to establish a new policy for financing spare parts and other support items as part of its direct long-term financing for aircraft sales.

The U.S. aircraft industry is concerned that any reduction in Eximbank financing for spare parts and other support items would adversely affect its capability to compete against foreign manufacturers for aircraft sales. The major U.S. aircraft manufacturers, however, said that they will cooperate with Eximbank to make the most effective use of the Bank's scarce resources.

In a November 1979 memorandum to the Board of Directors and staff, one Bank director said that Eximbank has been financing too many spare parts, accessory items, and services and for too long a period. The Bank has been supporting these items for the same 10-year repayment period as the basic aircraft. He said this was going on at a time when the Bank was trying to conserve its direct loan funds because of budget restrictions.

Based on Eximbank's fiscal year 1980 budget of \$1.8 billion for commercial aircraft financing, the director estimated that the Bank could reduce outlays from \$100 million to \$200 million by developing a more restrictive policy for financing spare parts and accessory items. He requested that the matter be discussed at an early date and a decision reached which could be announced to aircraft and engine manufacturers as a uniform policy to conserve Eximbank funds.

BANK STUDY OF FINANCING FOR SPARE PARTS AND CREDIT MEMORANDUMS

In April 1981, another Eximbank director informed the Congress that the Bank has begun to study the issue of credit memorandums within the context of overall allocation of Eximbank's limited resources. The present Board of Directors will recommend that the next Board determine whether present policy on credit memorandums should be revised to reduce the amount of spare parts and similar items included in the long-term financing for aircraft, given Eximbank's scarce resources. This director, however, was concerned that any limits on the use of credit memorandums will reduce the competitiveness of U.S. aircraft manufacturers at a time when Airbus Industrie has been making substantial inroads into traditional export markets for their products.

PROPOSAL FOR NEW POLICY

In April 1981, the director who questioned Eximbank financing practices proposed limiting Eximbank financing for spare parts and ground support equipment, including such items obtained with credit memorandums, to a maximum 10 percent of the aircraft cost. The proposal would also restrict the number of spare engines which could be financed depending on the number of installed engines involved in the sale.

The new policy would not affect previously issued preliminary commitments, and credit memorandums convertible to cash would continue to be subtracted from the Eximbank-financed portion of aircraft sales.

This director plans to submit his proposal to Eximbank's next Board of Directors for consideration. He said that the proposed reductions in Eximbank financing of spare parts and other support items would not adversely affect the competitive position of the U.S. aircraft industry. Under the proposal, Eximbank's loans to Ansett and Israel would have been reduced by millions of dollars.

U.S. AIRCRAFT INDUSTRY CONCERN
ABOUT FOREIGN COMPETITION

We discussed Eximbank's financing practices for spare parts, support items, and credit memorandums with officials of the three major U.S. aircraft manufacturers and the two major U.S. engine manufacturers. These officials were concerned that any reduction in Eximbank financing for spare parts and accessory items would adversely affect their capability to compete with foreign aircraft manufacturers. They were especially concerned about Airbus Industrie and said that the Governments of France, Germany, and the United Kingdom were providing financial resources and political support to advance the competitive position of Airbus.

The U.S. industry officials stated that an effective international agreement is needed to control governmental support for commercial aircraft sales. Accordingly, they support the U.S. Government's negotiations in the Organization for Economic Cooperation and Development to eliminate subsidized export financing. The officials believe that until such an agreement is reached, to do less than maintain a strong Eximbank would put U.S. exporters at a competitive disadvantage.

To compensate for anticipated reductions in Eximbank direct loan funds, one manufacturer has proposed private loans at market rates repayable over 18 years. These loans would require Eximbank guarantees. This manufacturer said that, although the

private loans would have higher interest rates, they would be attractive to the airlines because of the longer repayment period. If longer term Eximbank guarantees become available, insurance companies and pension funds may be willing to make these loans to the airlines. Regardless of what happens, this manufacturer and others expressed the desire to work closely with Eximbank to develop a loan priority system to effectively use available Eximbank resources.

Another manufacturer recommended that in view of Eximbank's tight budget situation, the Bank use available funds to provide adequate financing for the aircraft, including installed engines, and for capital items, such as spare engines and ground support equipment. Financing for expendable spare parts would be arranged through other sources such as commercial banks, manufacturers, and airlines.

Two manufacturers suggested that if Eximbank has to cut back on financing for commercial aircraft sales, it could reduce the overall funding level rather than limit coverage for spare parts and other support items.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AND AGENCY COMMENTS

Eximbank, to effectively use its scarce financial resources in competing with resources available to assist foreign aircraft manufacturers, should limit the amount of spare parts and other support items in direct long-term financing for commercial aircraft sales.

Support items usually have much shorter useful lives than the aircraft itself, and generally, shorter term loans, commercial loan guarantees, and insurance programs are more appropriate means for financing these items. In our opinion, excessive financing for these items on the same long-term basis as the major capital item does not contribute to efficient allocation of the Bank's funds. Although Eximbank should always carefully allocate funds, it is especially important in periods of restricted lending authority for it to use available resources as effectively as possible in assisting U.S. manufacturers to compete for commercial aircraft sales.

Eximbank financing limitations should apply to spare parts and other support items financed directly as well as those financed through the use of credit memorandums. The Bank, therefore, will have to know the amount of spares and other items to be obtained with credit memorandums before final loan approval.

After final loan approval, Eximbank should require manufacturers or borrowers to inform the Bank when credit memorandums are used to obtain spare parts and other support items. To reduce interest costs to the Government, Eximbank should not pay out loan funds for the value of credit memorandums until this information is obtained.

RECOMMENDATIONS AND AGENCY COMMENTS

We recommend that Eximbank establish a policy limiting the amount of spare parts and other support items that may be included in its direct long-term financing for commercial aircraft sales and that it delay disbursement of loan funds for items obtainable with credit memorandums until the memorandums are used.

Eximbank officials generally agreed that the Bank should establish a new policy for financing aircraft spare parts and other support items and said that our recommendation would be considered. In commenting on the second part of the recommendation, they said that Eximbank's procedures would have to be changed in order to withhold disbursement of loan funds until credit memorandums are used, and this would create additional administrative work.

We do not believe that implementing this part of the recommendation would create an unreasonable administrative burden on the Eximbank staff. The Bank could use the same procedures when spares and other items are obtained with credit memorandums as it uses when these items are obtained directly.